Nos. 11488-11489

In the United States Circuit Court of Appeals for the Ninth Circuit

CALIFORNIA AND HAWAIIAN SUGAR REFINING CORPORATION, A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITIONS FOR REVIEW OF DECISIONS OF THE TAX COURT OF THE UNITED STATES

SUPPLEMENTAL BRIEF FOR THE RESPONDENT

THERON L. CAUDLE,
Assistant Attorney General.
SEWALL KEY,
LEE A. JACKSON,
FRED E. YOUNGMAN,
Special Assistants to the Attorney General.

INDEX

CITATIONS

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SUPPLEMENTAL BRIEF FOR THE RESPONDENT

This supplemental brief is submitted on behalf of the Commissioner of Internal Revenue in response to the order of this Court entered July 21, 1947, setting out five questions to which the Court desires answers.

1. The first question asked by the Court is whether the records in these cases require the Court to sustain the Commissioner's disallowance of the refund claims involved because such claims were not properly verified and the evidence submitted to the Commissioner in connection with the claims was not under oath, as required by the applicable statute and Treasury Regulations. The parties since have stipulated that the respective claims were not defective in this respect and the answer to the first question is "no".

2. The second question asked by the Court:

> Is it the law of California that the transfer of title of raw sugar to a cooperative by its members is from the members as principals, continuing to own the sugar, to their cooperative as agent, which holds title as agent to dispose of the sugar and return the proceeds to the members as principals?

By way of suggesting the reason for this and the remaining questions asked, the Court quotes from the decision of the Court of Appeals of the State of California in *Bogardus* v. *Santa Ana W. G. Assn.*, 41 Cal. App. 2d 939, 108 P. 2d 52, which was not cited by counsel in their original briefs in this case dealing with the relationship between the cooperative and its members involved in that case.

Counsel for the Commissioner are sorry if they have inconvenienced this Court by failing to cite and discuss the above case and other cases of a similar nature, or by failing to discuss more fully in their earlier brief the questions in which the Court is interested. The failure to discuss these matters more fully was due to the fact that counsel did not deem them material to a determination of the narrow questions involved. For instance, the agency question, insofar as these cases are concerned, seems to be fully answered by the record and the federal statutes involved. At no time has the cooperative dealt with the Government as agent of its member producers. As a first domestic processor of sugar the cooperative was

liable for,[1] and paid, the processing tax involved on its own account. Is liability for the tax arose from the act of processing raw sugar, not from any relationship it bore to its member producers. The member producers were not first domestic processors of sugar within the meaning of the Agricultural Adjustment Act,[2] hence they were not liable for the tax, and the taxpayer could not have paid the tax for them as their agent.

Whether the taxpayer was processing the sugar received from its member producers as their agent or on its own account was unimportant under the provisions of the law and the Treasury Regulations in effect at the time the processing was done and the tax was paid. After enactment of Title VII of the Revenue Act of 1936, c. 690, 49 Stat. 1648, however, it became important in the selection of remedies for recovery. Ample authority is cited in the Commissioner's original brief to show that the remedial provisions of Title VII are limited to the person who was liable for and who actually paid the tax. But the provisions of Title VII provide different remedies for taxpayers who paid a processing tax as a result of processing a commodity on their own account and those who paid a

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[1] See Section 9 (a) of the Agricultural Adjustment Act, c. 25, 48 Stat. 31. as amended by the Act of May 9, 1934, c. 263, 48 Stat. 670; T. D. 4441, XIII–1 Cum. Bull. 501 (1934); T. D. 4549, XIV–1 Cum. Bull. 462 (1935); Article 11, Treasury Regulations 81.

[2] Section 9 (d) (6) of the Agricultural Adjustment Act, *supra*, as amended by the Act of May 9, 1934, *supra;* T. D. 4441, *supra;* T. D. 4549, *supra.*

tax upon the processing of a commodity for another for a fee or charge. Section 906 of the 1936 Act created the old Processing Tax Board of Review[3] and gave it exclusive jurisdiction to review the Commissioner's allowance or disallowance of claims for refund of amounts paid as "processing tax," as defined in Section 913 of that Act, while Section 903 of the Act gave concurrent jurisdiction to the District Courts and the Court of Claims over suits for refund of all other taxes paid under the Agricultural Adjustment Act.[4] Jurisdiction was denied the Processing Tax Board of Review (Tax Court) in cases where the amount claimed as a refund represented taxes paid upon the processing of a commodity for another for a charge or fee by the simple expedient of defining a "processing tax", over which the Board was given jurisdiction to exclude such taxes paid upon the processing of a commodity for another for a charge or fee. Section 913 (b) of the 1936 Act; *Arabi Packing Co.* v. *Commissioner,* 109 F. 2d 278 (C. C. A. 5th), certiorari denies, 310 U. S. 645. Compare *Fuhrman & Forster Co.* v. *Commissioner,* 114 F. 2d 863 (C. C. A. 7th), certiorari denied, 312 U. S. 686; *Lindner Packing & P. Co.* v. *Commissioner,* 118 F. 2d 656 (C. C. A. 10th). Hence, if this taxpayer were now claiming to have acted in an egency capacity during the tax period,

[3] Abolished by Section 510 of the Revenue Act of 1942, c. 619, 56 Stat. 798, and its jurisdiction and functions transferred to the Tax Court.

[4] The reason for providing these separate remedies is explained in S. Rep. No. 2156, 74th Cong., 2d Sess., p. 32 (1949–1 Cum. Bull (Part 2) 678).

processing the sugar of its member producers for a charge or fee, this Court very definitely would have to dismiss the appeals for lack of jurisdiction.

However, the taxpayer has disclaimed any notion of acting as agent for its member producers in the processing of their sugar during the tax period involved. It not only was required to, and did, file the returns and pay the processing tax on its own account, but the refund claims on which these proceedings were based were filed on its own account as the taxpayer, the proceedings below were instituted by it on its own account as the processor who paid the tax and was entitled to claim the refund, the statements attached to its refund claim were intended to show that as the taxpayer it bore a substantial part of the burden thereof, and in its original brief before this Court it definitely states (p. 20): "Petitioner did not file the claims and petitions in the cases at bar as agent". This statement seems to be fully justified under the terms of the agreement between the taxpayer and its producer members, which the Tax Court properly construed to be a contract of purchase and sale. (No. 11,488, R. 104–105.) Therefore, insofar as the present case is concerned, it would seem that the answer to the second question of the Court should be "no".

However, the second question as framed by the Court apparently contemplates an answer which would be decisive in all cases involving the relationship between cooperatives and their members under California law. We do not believe the question as framed will permit of a categorical "yes" or "no" answer.

Such an answer would of necessity eliminate or seriously limit any consideration of any marketing agreement between the cooperative and its producer members. This would seem to be inadmissible under the provisions of the Agricultural Code of California (Sections 1191–1221) dealing with cooperatives. Within the provisions of their charter and by-laws, cooperatives are given wide latitude in contracting with their members,[5] and Section 1208 of the Agricultural Code of California, relating to marketing contracts, specifically provides that:

> The association and its members may make and execute marketing contracts, requiring the members to sell, for any period of time, not over fifteen years, all or any specified part of their products or specified commodities exclusively to or through the association, or any facilities to be created by the association. If they contract a sale to the association, it shall be conclusively held that title to the products passes absolutely and unreservedly, except for recorded liens, to the association upon delivery; or at any other specified time if expressly and definitely agreed in the said contract. The contract may provide that the association may sell or resell the products delivered by its members, with or without taking title thereto; and pay over to its members, the resale price, after deducting all necessary selling, overhead and other costs and expenses, including interest on preferred stock, not exceeding eight percent per annum, and reserves for retiring the stock, if

[5] See Sections 1208, 1216, and 1221 of the Agricultural Code of California.

> any; and other proper reserves; and interest not exceeding eight percent per annum upon common stock.

It is conceivable that a contract of agency could be entered into by the cooperative and its producer members under the above provision, but we find no decision by any California court which holds that as a matter of law the relationship between the cooperative and its producer members is one of agency. Rather, the relationship in each case is generally made to turn upon the provisions of the cooperative's bylaws and its agreement with its members or upon general principles of equity. Cf. *California etc. Assn.* v. *Ridge L. & N. Co.,* 199 Cal. 168, where the marketing agreement specifically designated the cooperative as "agent" of the producer. See, also, *Poultry Producers etc.* v. *Barlow,* 189 Cal. 278.

3. The third question asked by the Court:

> Is it the law of California that such a transfer [of title] transfers the sugar to the cooperative as trustee of a trust of which the selling members are beneficiaries and the provisions of the trust are the terms of the contract of sale?

If this question contemplates a categorical "yes" or "no" answer applicable to all cooperatives under California law, regardless of the contractual arrangement with their member producers, we find the same difficulty answering it as we do with respect to the second question discussed above. We have found no California decision which seems to be all-inclusive. Here, again, the decision in each case seems to depend upon the particular arrangement between the cooperative

and its members as disclosed by its by-laws and the marketing or other agreement under which it operates. This is true of *Bogardus* v. *Santa Ana W. G. Assn., supra,* quoted from in this Court's order of July 21, 1947. In that case the appellants were contending that the marketing contracts were contracts of purchase and sale (p. 948), but the Court of Appeals held that the agreements between the local association and its members and between the central association and the local associations created a fiduciary relationship between them. The reasoning with which the court supported its conclusion is thoroughly convincing, but it cannot be accepted as a general proposition of law applicable to all California cooperatives regardless of their contractual arrangement with their member producers. *Mountain View, etc.* v. *California etc.,* 19 Cal. App. 2d 227, 65 P. 2d 80, upon which the court relied to some extent in the *Bogardus* case, involved the same marketing agreements and in that case the court pointed out that the parties had agreed that the funds involved were held in trust by the central association. Both suits were for an accounting under the particular marketing agreements involved and the comments in the *Bogardus* case with respect to the fiduciary relationship of the parties seem unnecessary to the decision of the question involved.

The other cases cited in the *Bogardus* case, *supra,* also are suits between cooperatives and their members, involving alleged breach of contract and claims for damage or an accounting. The rights of the parties in each instance depend upon the particular contract involved and general equitable principles. If this

were a similar action between the California and Hawaiian Sugar Refining Corporation and its producer members under their marketing contract, it is conceivable that for certain purposes, such as enforcing the contract or ordering an accounting, a court would view the case as involving a fiduciary relationship.

In *San Joaquin V. P. Producers' Ass'n* v. *Commissioner,* 136 F. 2d 382, this Court cited the *Bogardus* and *Mountain View* cases, and *Reinert* v. *California etc. Exchange,* 9 Cal. 2d 181, in support of its holding that the amounts which the Commissioner sought to tax to the cooperative in that case represented "net proceeds," resulting from operation of the cooperatives' business which never became the property of the cooperative. But that result was reached upon a consideration of the association's by-laws and the marketing agreement with its members. It would not necessarily follow that the same result would obtain under every marketing agreement. Instead, it seems that if a fiduciary relationship is to be imputed to the parties in a cooperative case it would arise as a result of their dealings with each other rather than by reason of the general provisions of the California Agricultural Code. Compare *Reinert* v. *California etc. Exchange, supra,* and *Cooperative D. League* v. *Hansen,* 23 Cal. App. 2d 493, 73 P. 2d 627.

As was stated with respect to the second question discussed above, counsel for the Commissioner did not discuss the relationship between this taxpayer and its producer members because the subject did not appear material to a determination of the narrow question

here involved. Regardless of the capacity in which the taxpayer acted in processing the sugar it did during the tax period, it was liable for the tax as a first domestic processor of raw sugar. Cf. *Savannah Sugar R. Corp.* v. *Commissioner,* 121 F. 2d 426 (C. C. A. 5th). Having been made liable for the tax, and having paid it as its own tax, it was the only one entitled under Title VII of the Revenue Act of 1936 to claim and sue for a refund. It claimed the refund on this basis, and submitted certain evidence which it insists shows that it bore at least a substantial part of the burden of that tax, which is a necessary condition to recovery under the statute. As pointed out above, if it refined the sugar for its producer members for a charge or fee it cannot recover in this action. Furthermore, if any theory of fiduciary relationship could be deemed determinative of its right to recover it would be precluded from recovering in this action. Its refund claims are not based on any such ground. The evidence submitted with its claims would not support an action for refund on any such ground, and no refund could be allowed on a ground not set forth in the refund claim. *Angelus Milling Co.* v. *Commissioner,* 325 U. S. 293; *Vica Co.* v. *Commissioner,* 159 F. 2d 148 (C. C. A. 9th); *Cherokee Textile Mills* v. *Commissioner,* 160 F. 2d 685 (C. C. A. 6th).

Although the order of this Court does not indicate any interest in the subject, the fact that title of the stock of the taxpayer was in voting trustees can have no bearing upon the issues involved.

4. The fourth question asked by the Court:

> If the transfer of title of the sugar is in such a trust does the cooperative as trustee, by paying the processing tax out of the corpus of the trust, shift the burden of the taxes by the reduced amount distributed to the beneficiary members?

If in framing this question the Court used the term "corpus" advisedly, the question is a purely theoretical question for which there is no basis in the record. If a trust is assumed, which we do not admit insofar as these cases are concerned, the trustee would as a general proposition of law be required to pay operating expenses, which includes the taxes here involved, out of operating income rather than out of the "corpus" of the trust so long as operating income were available. And we submit there can be no question in these cases, on the facts shown by the record, that the taxes here involved were paid out of current operating income.

If by its question this Court intended the term "corpus" to include current operating income of the taxpayer, we think it is clear from the terms of the taxpayer's agreement with its producer members that, as held by the Tax Court, the burden of the tax involved was shifted in the first instance to—or more specifically, was assumed by—the producer members. Where the burden ultimately rested, whether upon the producer members or upon the purchasers or consumers of the refined sugar, is immaterial to the question here involved.

5. The fifth question asked by the Court:

> Under the facts alleged in the petitions to the Tax Court, if the sugar be resold by the cooperative at a net loss, does the loss fall on the beneficiary members or on the capital of the cooperative trustee?

We regret we are not sure what the Court means by "net loss" in this question. If by "net loss" the Court means the loss that would result if the taxpayer resold the sugar delivered to it at a price which, when added to all other income, was insufficient to cover its operating costs and other deductions authorized by the agreement with its producer members, without considering any advances to such members as cost of sugar purchased, we think the answer would be "yes" because the contract does not provide for the recovery of any such loss from its members. See also, Section 1206 of the Agricultural Code of California. But such a situation would seem highly improbable. We answer the question in this manner because we do not think the Court intended to include as an element of cost in computing a "net loss" any part of the initial payment or other advances to its members on account of sugar delivered by them. While the particular contracts here involved do not specifically so provide, we believe that if the proceeds received from the sale of sugar, plus all other income of the taxpayer, were insufficient to cover all expenses plus other authorized deductions—except the 6% which the taxpayer is authorized to retain for its own purposes—the taxpayer would be entitled to recover from its producer members any advances which later proved to be in

excess of the total amount to which they were entitled under the contract. Thus, if the proceeds received from the sale of the sugar, plus all other income, exceeded all expenses and other authorized deductions any further loss would apparently fall upon the producer members.

Respectfully submitted.

THERON L. CAUDLE,
Assistant Attorney General.
SEWALL KEY,
LEE A. JACKSON,
FRED E. YOUNGMAN,
Special Assistants to the Attorney General.

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